THE TRUE BASIS OF FIRE INSURANCE

In a recent number of THE ANNALS, the undersigned sought to show that "Underwriting profits such as are insisted upon by the insurance companies are in the nature of extortion." In support of this assertion, the condensed Income-and-Outgo account of the American fire insurance companies reporting to the Insurance Commissioner of Connecticut was, *inter alia*, cited from this official's public report. The figures quoted were those actually sworn to and presented by the companies themselves. Yet they were referred to by an organ representing the fire insurance interests, in this wise: "He (the author) has tried to assimilate the Connecticut Fire Report for the present year, but his maldigestion has produced the following astonishing net return, which shows a profit so large that even the sellers of certificates in gold mine probabilities could not duplicate it:" (Here followed a reproduction of said Income-and-Outgo account.)

The astonished apologist whose words have just been quoted goes on to say that "the experience of all companies with assets of $1,000,000 or over" during "the year 1898 showed an underwriting loss of 1½%; 1889, 13¾%; 1900, 4¼%; 1901, 4¼%. The balance for 1902 was in the companies' favor, showing an underwriting profit of a fraction over 4%."

Let us look at the results of the operations of the Joint Stock Fire Insurance Companies doing business in this country, and let us deal with those very same years when the "million dollar companies" saw such hard times. Yet first, let us remember the favorite trick, exemplified above, of the Fire Physician: it is his habit to play upon your relative ingenuousness, and whilst you, in broad general terms, talk of fire insurance "business," he will discuss mere "underwriting." Very carefully does he insist on this casuistic distinction between "underwriting" and the other uses of money furnished by the assured; for it is in this distinction that he finds your undoing. You would not seek long for the retort destructive, if an innkeeper talked of his "losses" in a vein such as this: "With few exceptions, every meal I serve has meant a loss—in fact, I shall have to raise the price of meats 25% to every guest. However, the glass of beer will continue to be sold at 10 cents." You would know that because

his till is full of money from meals on which he makes but 10%, he can pay cash for kegs of beer on which he makes 300%. Just as illogical is it for the fire insurance companies to say: "with few exceptions, every time we do any underwriting we do so at a loss. In fact, we must raise rates 25%. However, our loans on first lien mortgages will not be dearer."

That these words of the underwriters may be viewed in all their sophistry, it should be remembered that the premium paid in by the assured is used for many purposes other than mere underwriting. You, the assured, pay a million dollars to the insurers, and, in return, receive promissory notes (called policies) collectible in certain contingencies. What happens to that million dollars? Does it lie dormant and unproductive? Patiently useless, waiting on contingencies, which make it refundable? Not for a minute! It goes immediately into real estate, loans on collateral security, "brisk sales on the advance," commercial paper, call money, usury, and other forms of banking—in fact, into the various channels in which clean, liquid gold can flow with profit. However, all these channels for gold have no direct connection with fire or "underwriting," and though these secondary uses of this aforesaid million dollars of premium-money may produce a hundred thousand dollars per year, this usufruct will be masquerading as "investments," and will be invisible in the accounting of your mere premiums. Further, if you, the assured, have been unwarrantably overcharged, so that the great bulk of your premiums is still intact when all your fires have been paid for, the overcharge will not be carried over to the credit of next year's "underwriting" account; no, henceforth and forever, it figures entirely in the surplus funds, its employment swells the "investment" account and that, too, is unconsidered on the day when the guileless policyholder asks whether his premium bills are not much too high. Some apologist or other merely tells him of the "underwriting" results and asks him to reflect in apologetic humility upon the "underwriting" profit "of $\frac{46}{100}$ of 1% for the last 10 year period." For the kitchen accounts have nothing to do with the bar!

To return to those niggardly years beginning with 1898; and let the *ipse dixit* of the Superintendent of Insurance of the State of New York appear.

The Fortieth Report shows "the nature of the receipts" of the Joint Stock Fire Insurance Companies "of the United States and

United States branches of Foreign Fire Insurance Companies of other countries authorized to transact business in this State, for the year ending December 1, 1898." These receipts are tabulated upon pages XCV to C of this Report. The various amounts of income are correctly counted, in accordance with the first rules of elementary arithmetic, and the Superintendent of Insurance gives us the resultant "Total receipts in cash." Since then he has given us every twelve-month the corresponding figures for succeeding years. By plain copying from each of these consecutive reports, the following table is obtainable:

"TOTAL RECEIPTS IN CASH."

Year 1898	$139,209,525
1899	146,644,663
1900	158,289,098
1901	175,588,073
1902	221,165,307
1903	213,695,274
Total for the period	$1,054,591,940

In just the same way, the very next tables in each of these reports show the "Nature of the Disbursements." Each of the main items is given and then the report, still adhering strictly to elementary arithmetic, gives the "Total Disbursements." So that, again, by plain copying the following table is obtained:

"TOTAL DISBURSEMENTS."

Year 1898	$131,558,044
1899	150,662,824
1900	155,102,232
1901	163,907,522
1902	177,791,164
1903	182,218,555
Total for the period	$961,240,341

As will be shown presently, the balances of shipments of money between offices here and the home offices in Europe are not included in the above disbursements. These balances add about $10,000,000 more, bringing the total disbursements for the years given up to $971,240,341. If we compare these amounts, we find that the "Total receipts in cash" have been in excess of the "Total Disbursements" for the last six years, 1898–1903, inclusive, by more than $83,000,000.

With absolute impartiality, the Superintendent of Insurance for the State of New York, has merely reproduced the individual sworn reports of the several fire insurance companies themselves, each giving under oath "a just, full and true statement of the affairs and condition" of each company on the 31st of December of each year. 145 Joint Stock Fire Insurance Companies are represented in the aggregate of 1903.

In order to understand the full value of these results one must see what items are comprised in these "total receipts in cash" and "total disbursements." For purposes of illustration the last year (1903) is taken. From page C (Recapitulation) and CVI (Recapitulation) we gather the following totals under the several heads:

INCOME	
Premiums written	$196,532,867
Interest and dividends	11,581,031
Rent	1,371,564
From other sources	4,209,811
Total income	$213,695,273
OUTGO	
Losses	$96,834,017
Commissions	41,888,572
Officers' salaries	12,035,013
National, State and local taxes	5,474,157
DIVIDENDS	7,124,425
Other disbursements	18,862,371
Total disbursements	$182,218,555

To this Outgo there should be added the profits of the Foreign Insurance companies, represented by the "balance of remittances to and from Home offices" in Europe. This sum was about $3,000,000, and corresponded to the dividends of American companies, although it became dividends only after reaching London and other home cities. Adding this amount to the dividends, we get the "total disbursement," $185,218,555, and an excess of income over disbursements of every kind amounting to $28,476,718 for the calendar year 1903. By reference to page LXXIII of the same report (New York

State 45th Report), it will be seen that the "paid-up capital" of the American companies together with the "net assets or U. S. capital" of the Foreign Companies amounted, in the aggregate, to less than $80,000,000. So that, despite the fact that 30% of the total disbursements went to "commissions" and "officers' salaries," these companies distributed over 12% dividends on the aggregate capital and carried forward an extra 35% on the whole capital invested in the business! These last six years, then, four of them "starvation years" produced $83,000,000 of excess income over disbursements—104% on the entire cash capital, and that, *after* deducting yearly over 11% for dividends and fabulous sums for commissions and other wild extravagance!

It is no answer to such accusing facts to be told that many companies lie in their graves: some were smothered that the survivors might claim a bigger share of the monopolized spoils; others, conceived in indignation and born in anger, were bludgeoned in their frail infancy; more were choked by their excessive greed, eating poisoned fruit; and still more disappeared, bled to death by faithless servants. Diamonds, to-day, given the cost of production, are extortionately dear, though hundreds of mines succumbed to the Beits and Cecil Rhodeses. So it is with fire insurance.

The average business man, if given time and opportunity further to analyze the various items composing the "total disbursements" of the fire insurance companies under review, would be dumbfounded on seeing the mountain of extravagance, of needless and crying waste displayed year after year. He would be amazed to find that conditions which long ago called for a remedy of an immediate and radical character have been perpetuated and aggravated until to-day they are worse than they ever were. The result is seen in the fact that in 1903 the average cost of fire insurance in the United States was much higher than at any time in the preceding half century. And the burning shame of it all is, that all the waste, all the extravagance, all the greed and folly, all the incendiarism and criminal negligence has to be paid by the honest, the vigilant and the diligent, who do not, and cannot afford to, burn down.

Will conditions improve as far as the public is concerned? Whilst matters are worse to-day than ever before, there is as yet no indication that the necessary radical and sweeping changes which alone can bring alleviation, if not a remedy of the evil, will spring from

the companies themselves. Who among them should seek a change? The stockholders? $10,000,000 dividends last year, plus $28,000,000 added as a surplus. The management? "Officers' salaries," $12,000,000. The brokers? $42,000,000 for "commissions." The hangers-on? $19,000,000 for "other disbursements." Looking from their point of view, does any sane man believe that the guests at this Gargantuan feast are going to work for a Lenten fare just to benefit the business man? Why, it would be utterly unbusiness-like, wildly chimerical, absurdly altruistic for them to do anything of the kind. The last thing that the fire insurance companies will do will be to write a 1 for every 3 in the disbursement column. Why should they grow perturbed about the outgo? The public always foots the bills! Is it Baltimore you think of? Now that all the policies have been honored and paid for, the total loss thereunder is less than $30,000,000. The stockholders have had to disgorge last year's surplus and may be asked to get along with a beggarly 6% dividend for this year, but in the meanwhile they are buying some new traps to catch back all the loss; and catch it they will!

Is there anyone knowing the actual conditions of fire insurance and of our cities throughout the country, who can honestly aver that, given a sincere desire on the part of the companies they could not halve the insurance bills of the country? If they seriously contemplated such a reform, could they not, for instance, rid themselves of that vampiric horde that exclaims, "You must do business in our State through us, and us only, and our charge is $42,000,000 per year?"

No one, too, who has considered the subject dispassionately can doubt that if the heads of the insurance companies chose to adopt forceful, intelligent measures, strictly within their legal and constitutional rights, they could, by concerted action, within a reasonably short time, so far remove the causes of fire and its extension as to make the chance of conflagrations exceedingly remote, and the yearly fire loss of the country less by a half. For instance, if only half of the $42,000,000 which was squandered last year (mostly to renew policies, which would have been renewed anyhow) had been devoted to improving inspections and to the thorough cleaning-up of risks, every cent thereof could have been saved in reduced fire loss, immediate and deferred. As it is, the inspection of the Joint Fire Insurance offices, in innumerable instances, are of

a solemnly farcical perfunctoriness only comparable to the inspection of trunks passing through certain of His Majesty's Customs! Whilst dozens of glaring and startling deficiencies in such "thorough inspections" could be cited from casual personal observation, the following excerpt from this year's "Report of the Insurance Commissioner of Connecticut" (39th Report, page XXIX) is official. With reference to bad conditions discoverable, one reads: "For example, in inspections made last year of 83 buildings, all contiguous in one of the largest cities, 17, or about 20%, were found to be in such dangerous condition that it was necessary to serve notices on the occupants that same must be remedied at once." Again, the Report of the Fire Insurance Patrol of the City of Philadelphia, for the year 1903, says (page XI): "During the year, the Patrol added to its work an Inspection system to cover the congested districts; work was commenced November 10; * * * many defects were found; * * * As a matter of interest to our members some of these defects are mentioned:

"Gas stoves, showing fire under same, 152; gas leaks, 16; gas brackets, swinging, showing fire marks, 56; gas jets, not properly guarded, 78; gas jets, close to stock, 85; gas bags for gas engines, defective, 2; Bunsen burners, showing scorched woodwork, 6; sawdust under lighted gas stoves, 2; and numerous other defects arising from improper use of gas. Broken windows, 590; steam pipes, defective, 75; steam pipes contact with stock, 72; rubbish on steam pipes, 63; there were also numerous defective flues, bad arrangement of steam pipes, electric lights, open grates, stoves, heaters, etc., etc.; also many cases of hot ashes in wooden boxes, rubbish, and general bad policing of risks."

Immediately preceding the paragraph just cited are these words: "During the last five years the results in this district (Congested District) show that 42% of the loss of the whole city occurred there, * * * while but 25% of the premiums came from there * * * These figures, of course, show a heavy loss for the period."

Here is a small district of Philadelphia that for at least five years shows "a heavy loss," "42% of the loss of the whole city," and yet, "work was commenced on November 10" (1903) and, in a few days hundreds of dangerous fire-inviting conditions are discovered right in the heart of the conflagration district!

When these things happen under the very noses of the fire officers,

it is easy to understand why conditions of the gravest danger are to be found at remoter distances, to the constant peril of the community and for the perpetuation of inordinate fire bills.

The fire insurance officers could insist on profits due to fire prevention, but, in the main, they choose to make money by permitting big losses and raising rates afterwards. As is their inspection of cities, so is their inspection of men. Do they shun a man who, heedless of his own danger and scornful of the perils to his neighbors, refuses to adopt the most elementary rules of safety? Do they compel him to protect his premises and its contents? Seldom; and then, in a half-hearted fashion! As a rule, conditions which invite fire and render its spread almost certain cost sometimes less sometimes no more, sometimes but a little more than conditions which render the spread of fire almost impossible.

Every underwriter knows that science long ago gave us automatic devices, unfailing in action, whereby a flood of water automatically plays upon a fire breaking out anywhere in a building, effectually preventing its spread and often extinguishing the flames. These devices are so cheap that equipment companies will install them free of extra cost to the insured. Were the owners of warehouses and stocks in Baltimore, where values under single roofs ran into a million dollars without being thus protected, refused insurance because of obvious negligence so inexcusable as to be criminal in its shortsightedness? Not at all. Was this wholesale district, peppered with dozens of instances of such foolhardy recklessness, placed under a ban, compelled by utter inability to procure insurance, to install automatic fire extinguishing appliances? Not at all. No more than they are in dozens of cities that can be named. Due notice, followed in the event of general apathy by one emphatic "No insurance to offer" all along the line, could have compelled Baltimore, inside of a year, to make itself immune against sweeping conflagrations. The refusal to accept the local premiums for a year would have saved the companies and the public $30,000,000 in indemnity, and would have meant as a reward for a year's abstinence, a profitable business for years after the ban had been removed.

It will be urged that such joint action could only be reached as the result of conspiracy, punishable at law. By what process, forsooth, do a hundred fire offices in a city so stifle competition that their uniform charge for insuring certain merchandise lying in a

particular building is, say, $1.7639 per $100—the price not varying half a cent, though you rap at the doors of the hundred underwriters? By conspiracy, of course. And conspiracy for obvious public benefit could not be more reprehensible than for covert public pillage. But the more dangerous the conditions, the higher the premium; the higher the premium, the greater the commission, and the greater the scramble among the agents to induce their home offices to issue dangerous policies. Apart from adequate inspections, moral and physical, and the conflagration cure, is there anyone competent to speak who believes that the losses due to isolated fires could not be materially reduced by heroic remedies applied after a fire for the purpose of preventing recurrences. For instance, fires happen every year, in 500 school houses, 600 churches, and 1400 hotels, and yet the conditions which produce these fires are being perpetuated. Why? In the greatest measure, because the fire insurance companies contemplate such visitations with imperturbable equanimity! The losses come out of the pockets of those who do not burn down. All that the brokers' principals do is to see that enough people with property relatively immune against fire pay into the pool enough money to refund the losses of those sure money-losers who bribe heavily for admission to the same pool.

Yet, after all is said and done regarding the administration, it is the *system* of insurance that, in the main, is defective. Born long ago under conditions to which it was then far better adapted, it has withstood the commercial revolution, the industrial upheavals, and, as a whole, has stood unchanged, stubborn and unbending, while the whole business world about it was being transformed. Unless the ferment within is already at work producing changes not yet visible outwardly, it looks as if the revolution in insurance methods will have to be wrought through external agencies. Present conditions cannot continue long after the business man realizes that the figures in his insurance bills cover mostly disbursements for criminal negligence and apathy, greed, incendiarism and a thousand preventable causes of fire and conflagration, and while the genuinely unavoidable cost of fire could be covered for a tithe of what he now pays. The whole business community is wretchedly served and badly abused in its confidence; it should work out its own salvation and not wait to have it worked out by others. There is furthermore a large section of this same community that should seek special

relief because it can get special relief from this evergrowing burden and abuse: it is that section which, besides being sound and upright, financially and morally, has its property in such a condition that the probability of fire is much below the average—the class of insurers who do not burn down and who, under existing conditions, pay for the losses of those who can afford to burn down, who do burn down—in fact, pay the whole insurance bill of $200,000,000 a year. It is that class of hotels, of newspaper plants, of furniture houses, of breweries, of clothing makers, of hardware dealers, with the excellent record who to-day are charged a "basic rate" by grouping them with those who have the bad record and will continue to have fire.

What is to prevent the elect in these industries and a dozen more from forming mutual fire insurance companies, membership in which would be confined solely to persons engaged in the same industry, known to each other as prosperous and of good character, with premises of a high standard viewed from the point of fire prevention, and scattered widely throughout the United States? Such associations would begin, preferably, by assuming but a portion of the risk of the members, the remaining portion being insured through the old companies. As the funds of such associations grew, the amount of the policies of the several risks could be gradually increased until in time all the indemnity needed would be furnished. Space is lacking here to show in detail how such a plan can be made most effective, to indicate what difficulties will have to be surmounted, what safeguards adopted, what antagonisms overcome. Yet certain principles are fundamental to deserved success: the excellence of the mutual plan must not be permitted to serve as a shield for the selfish efforts of unscrupulous promoters and managers. Every plan, also, should fix a limit upon expenses of management compatible with efficient administration: 20% of the premium income should be ample for this purpose. Another principle which must be closely watched involves the indispensable scattering of risks, so that no two might succumb to one and the same fire. To carry risks crowded into one district or city is to invite disaster by a sweeping conflagration. The chain of houses so formed should have one common industry as a bond of union. The failure to observe these elementary safeguards has been the cause of the collapse of many a mutual company.

Given intelligent management and loyal co-operation among the members, there is scarcely an industry in this country which cannot

form such associations for mutual benefit and thereby reduce its present cost of its insurance 50 to 70%.

To many it will be a surprise that such associations have been in existence on an extensive scale in this country for over fifty years and have demonstrated that there is nothing visionary or impracticable about the plan of Mutual Insurance against fire loss. In the year 1835, Zachariah Allen of Providence, R. I., organized the Providence Manufacturers Mutual Fire Insurance Company. In 1848, the Rhode Island Mutual Fire Insurance Company was established. These companies were associations of manufacturers engaged mostly in the textile industries. To-day there are over thirty of such companies with headquarters in New England and Philadelphia. True to their original intent, their membership is still confined to mills and factories; some of these companies specially exclude certain classes of property whilst others admit them. In view of their membership they are popularly known as the "Factory Mutuals." These companies are banded into one association for all purposes of common utility and for the greater economy of management. Insofar as manufacturing properties are concerned, they have been instrumental in revolutionizing insurance, and they have developed the science of fire prevention to a degree of perfection which, to the lay-mind, must be amazing. Although they will insure nothing but mills and factories, although the consequent inherent hazard of fire is admittedly greater than the general hazard of the community at large, nevertheless they have succeeded in furnishing their members with the soundest, yet cheapest, fire insurance. They have done it by enlisting self-interest in the prevention of fires. They have striven to anticipate fire rather than to cure it. There can be no more eloquent tribute to the results thus obtained by the Factory Mutuals than to say that the cost of their insurance is but one-eighth of the average cost of insurance in this country last year.

Individual company results still more brilliant than these could be cited, but it is a fairer illustration of the system to indicate the general results obtained. The joint business of these companies for the last year obtainable is indicated below. Space is lacking for more than this summary, as the whole subject is too big to be dealt with, save specially. It should be remembered, however, that the plan pursued by all these companies is to charge a certain equitable

premium on the issuance of policies, to debit this amount with its proportion of expenses and losses, and then to refund to policy holders as "dividends" such portions of the full-earned premiums as the respective Boards of Directors deem advisable to return.

	1902.
Amount of insurance carried	$1,253,358,000
Net premium thereon	9,688,956
Average gross cost of a policy for $100 (before dividends)	77⅓c.
Total losses incurred	979,741
" expenses incurred	617,954
" taxes paid	134,495
" disbursements	1,732,190
Dividends on premiums of terminated policies	7,343,261
Average rate of dividend of all companies	81.45%
Average net cost of a policy for $100 (after dividends)	14.35c.

These figures show that the average net cost of insuring the mills and factories on the mutual plan was 14.35 cents per $100 in 1902. By contrast, the average cost of insuring the general hazards of the country under the system pursued by the Joint Stock Insurance Companies was over 115 cents per $100 in 1902 and over 118 cents per $100 in 1903.

The full significance of the startling disparity between these results need not be indicated here. In the foregoing pages the reason for such disparity has been partly shown. The lesson to be derived from such comparative results should not go without practical application by the best representatives of the mercantile community: if it is possible and highly profitable for hosiery, shoddy, rubber, paper, shirt, felt, carpet, hardware, silk, cotton and other kinds of mills and factories to insure on the mutual plan for 14 cents per $100 per year, why should this example not be followed by the most enlightened and most intelligent members of the defrauded and plundered mercantile community? If the mills and factories, by the introduction of common sense into fire insurance, can economize some fifteen million dollars a year, why should these methods not be copied wherever they are susceptible of application?

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